In the Supreme Court
OF THE
United States

OCTOBER TERM, 1974

No. 74-742

FOREMOST-McKESSON, INC.,
Petitioner,

vs.

PROVIDENT SECURITIES COMPANY,
Respondent.

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Foremost-McKesson, Inc.,	*Petitioner,*
vs.	
Provident Securities Company,	*Respondent.*

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

It is undisputed that when Provident Securities Company (hereinafter "Provident") made its single and only "purchase" of securities of Foremost-McKesson, Inc. (hereinafter "Foremost") it did not own any other security of Foremost.[1] Accordingly, under § 16(b) of the

[1]Throughout this brief we assume arguendo that Provident's acquisition of the Foremost securities was a "purchase" within the meaning of § 16(b) of the Securities Exchange Act of 1934. As is discussed in Provident's conditional cross-petition for a writ of certiorari (at pp. 10-14) filed on December 17, 1974 (No. 74-758), we believe that there was no such "purchase" and that therefore the transaction is also exempt for that reason.

Securities Exchange Act of 1934 (15 U.S.C. § 78p(b); 48 Stat. 896), Provident was not a statutory "insider" until after consummation of the very purchase here in question. Section 16(b) provides an express exemption for "any transaction where such beneficial owner was not such *both at the time of the purchase and sale* • • • of the security involved" (15 U.S.C. § 78p(b); 48 Stat. 896; emphasis added). The Ninth Circuit held that Provident's acquisition was exempt under that provision (Appendix to Petition, pp. 11a-29a).

Foremost errs in its assertions that there are "numerous federal court decisions" (Petition, p. 9) and "a substantial body of precedent" (Petition, p. 14) to the contrary. Only two Courts of Appeals other than the Ninth Circuit (the Second Circuit and the Eighth Circuit) have passed upon the question here involved (*Stella v. Graham-Paige Motors Corporation* (2 Cir. 1956) 232 F.2d 299, 300-301; *Emerson Electric Co. v. Reliance Electric Company* (8 Cir. 1970) 434 F.2d 918, 923-924, affirmed on other grounds, *Reliance Electric Co. v. Emerson Electric Co.* (1972) 404 U.S. 418). The Second Circuit affirmed, without analysis, the construction of a district judge. The Eighth Circuit, commenting upon the "paucity of judicial decision on the precise question presented" (434 F.2d 923), decided to follow the Second Circuit (434 F.2d 924). Contrary to Foremost's contention (Petition, p. 9), there is no holding of the First Circuit on the question.

Neither the Second Circuit nor the Eighth Circuit analyzed, as did the Ninth Circuit, the legislative history of the language here in question. As we will show, that analysis demonstrates that the Ninth Circuit's holding is

in accord with the terms of the statute, its history, and its purpose. It is also in accord with this Court's observation that § 16(b) is not aimed at speculation which "could not have been based on inside information obtained from substantial stockholdings that did not yet exist" (*Kern County Land Co. v. Occidental Corp.* (1973) 411 U.S. 582, 597).

QUESTION PRESENTED

Section 16(b) of the Securities Exchange Act of 1934 is applicable to "any purchase and sale" by a "beneficial owner of more than 10 per centum of any class of equity security • • • which is registered pursuant to this section" but exempts "any transaction where such beneficial owner was not such both at the time of the purchase and sale" (15 U.S.C. §§ 78p(a), (b); 48 Stat. 896). Foremost's statement of the question ignores this statutory language and also includes reference to irrelevant matters.

The question presented is: When a person becomes a beneficial owner of more than 10% of an issuer's securities as a result of a purchase of those securities, was that person a beneficial owner of the securities "at the time of the purchase"?

STATUTES AND REGULATIONS

Sections 3(a)(13), 3(a)(14), 10(b), 16(a) and 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78c(a)(13), (14), 78j(b), 78p(a), (b); 48 Stat. 882, 884, 891, 896) and Securities and Exchange Commission Rule 10b-5 (17 C.F.R. § 240.10b-5) are reproduced in the Appendix to this Brief.

STATEMENT OF THE CASE

A. The facts.

As Foremost acknowledges (Petition, p. 3), the basic facts of this case are undisputed. Those facts, however, are not fully nor accurately set forth in Foremost's brief. We therefore present the following statement:

Provident, now dissolved, was a personal holding company which in 1969 decided to liquidate. In order to have liquid assets to distribute to its shareholders in the liquidation, Provident entered into a contract with Foremost under which Foremost agreed to purchase approximately two thirds of Provident's assets in exchange for cash and Foremost convertible debentures to be issued expressly for that purpose. During those negotiations, Foremost had complete access to Provident's books and records.[2]

Although Provident wanted to receive only cash and no securities, it accepted the Foremost debentures in a compromise under which Foremost agreed to accommodate the sale of up to one half of those debentures as soon as possible. Provident thereafter received the Foremost debentures pursuant to the single contract under which Foremost purchased Provident's assets. Prior to acquisition of the debentures, Provident had no legal or beneficial ownership in any security of Foremost. As Foremost notes, the debentures were immediately convertible into common shares comprising more than 10% of Foremost's common stock (Petition, pp. 3-4). Shortly

[2]Foremost refers (Petition, pp. 2, 7) to the Ninth Circuit's speculation that Provident "could well have had" access to inside information about Foremost (Appendix to Petition, p. 7a). The fact is that it was Foremost that had access to information about Provident.

thereafter, pursuant to the contract between Provident and Foremost, Provident sold one half of the debentures received.[3]

The question whether any actual profit was realized and, if so, the amount of such profit was left open in the proceedings below and was not decided by either the district court or the Court of Appeals.

B. The proceedings below.

The decision of the district court: The district court granted Provident's motion for summary judgment on the question of nonliability. The court based its decision on an examination of "the surrounding circumstances and the equities inherent therein" (Appendix to Petition, p. 39a), concluding that the transaction was not subject to speculative abuse (Appendix to Petition, pp. 39a-41a). The district court did not pass upon any of the other grounds advanced by Provident.

The decision of the Court of Appeals: On appeal, the Court of Appeals disagreed with the district court's holding and rejected or did not pass upon other grounds advanced by Provident. Those grounds are discussed in

[3]For the purposes of the question presented by Foremost's petition, the date of the sale is irrelevant. However, we do not agree with the contention (see Petition, p. 4) that the date of sale was October 21, 1969 (see Provident's conditional cross-petition for a writ of certiorari in No. 74-758, at pp. 14-15). We also do not agree with Foremost's assertion that the Form 4 statement filed by Provident shows "the sale as of October 21, 1969" (Petition, p. 5). That form on its face reports a sale "*pursuant to* an Underwriting Agreement *dated* October 21, 1969" (Appendix to Petition, p. 44a; emphasis added). The underwriting agreement itself defines "the time of purchase" by the underwriters as October 28, 1969.

Provident's conditional cross-petition for a writ of certiorari (No. 74-758).

The Court of Appeals affirmed the judgment because Provident had not owned any security of Foremost when it entered into the contract under which it received the Foremost debentures. The court held that therefore Provident was not a beneficial owner of any security of Foremost "at the time of the purchase."[4]

ARGUMENT

I. NO OTHER COURT HAS EXAMINED THE PROVISO HERE IN QUESTION IN LIGHT OF ITS HISTORY.

Only two other Courts of Appeals have passed upon the question here in issue.[5] The Second Circuit approved, without analysis, the holding of a district judge that an initial acquisition of more than 10% was a statutory purchase (*Stella v. Graham-Paige Motors Corporation* (2 Cir. 1956) 232 F.2d 299, 300-301, affirming *Stella v. Graham-Paige Motors Corp.* (S.D.N.Y. 1952) 104 F.Supp. 957, 959).[6]

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[4]Foremost emphasizes that this argument was not "urged" by Provident (Petition, pp. 6, 7). It was not so urged because Provident believed, as it still believes, that there also exist several other grounds in support of the judgment. Although not urged, the argument in fact was noted in Provident's brief. In its reply brief, Foremost did not respond to that argument nor did it file a petition for a rehearing by the Court of Appeals.

[5]The First Circuit decision cited by Foremost (*Booth v. Varian Associates* (1 Cir. 1964) 334 F.2d 1) involved director insiders and not beneficial owners of securities (334 F.2d 2, 3). The proviso here in question applies only to beneficial owners and it has long been recognized that § 16(b) treats "directors and officers as one category of 'insiders' and 10% beneficial owners as another" (*Adler v. Klawans* (2 Cir. 1959) 267 F.2d 840, 845).

[6]The Second Circuit later restated its views in dictum in *Newmark v. RKO General, Inc.* (2 Cir. 1970) 425 F.2d 348, 356.

The district judge in *Stella* had based his decision solely upon the fear that, under any other interpretation,

> "• • • it would be possible for a person to purchase a large block of stock, sell it out until his ownership was reduced to less than 10%, and then repeat the process, ad infinitum" (104 F.Supp. 959).

As the Ninth Circuit pointed out, such a result should not—and would not—be permitted:

> "Where a shareholder was within a class of persons who had access to inside information by reason of their relationship to the issuer prior to making his initial decision to speculate, the conclusive presumption should be applied if simultaneously with the conclusion of the closing transaction he is the owner of 10 percent of the issuer's stock" (Appendix to Petition, p. 26a).

Neither the Second Circuit nor the Eighth Circuit, which subsequently followed the Second (*Emerson Electric Co. v. Reliance Electric Company* (8 Cir. 1970) 434 F.2d 918, 923-924, affirmed on other grounds, *Reliance Electric Co. v. Emerson Electric Co.* (1972) 404 U.S. 418), examined the legislative history of the proviso. The two commentators cited by Foremost (Petition, p. 12) also ignored that history. Every commentator of whom we are aware who has examined the legislative history has reached conclusions in accord with those of the Ninth Circuit (see Insider Liability for Short-Swing Profits: The Substance and Function of the Pragmatic Approach (1974) 75 Mich.L.Rev. 592, 602-606, 616-619; Section 16 (b): An Alternative Approach to the Six-Month Limitation Period (1973) 20 UCLA L.Rev. 1289, 1312, ftn. 125; Note (1957) 9 Stan.L.Rev. 582).

We respectfully submit that, as is discussed in the section which follows, the Ninth Circuit's holding is correct. We also respectfully suggest that, if the Second Circuit and Eighth Circuit were to reconsider the question in view of the material analyzed judicially for the first time in the opinion below, they might well reach the same conclusions as the Ninth Circuit.

II. THE OPINION OF THE COURT OF APPEALS IS IN ACCORD WITH THE TERMS OF THE STATUTE, ITS HISTORY AND ITS PURPOSE.

Foremost dismisses the Ninth Circuit's detailed review of the legislative history without discussion (Petition, p. 15). Instead, it merely refers to a purported analysis of the legislative history by the Securities and Exchange Commission wherein the Commission asserted that the exemptive provision was designed solely to exclude "other than a voluntary purchase or sale" (quoted at Petition, pp. 15-16, ftn.). As this Court has already pointed out, this limited construction is based upon "a fragment of legislative history" and "not only strains, but flatly contradicts, the words of the statute" *(Reliance Electric Co. v. Emerson Electric Co.* (1972) 404 U.S. 418, 425, 427).

Foremost also argues that § 16(b) should be "broadly interpreted" (Petition, pp. 10-11). This Court has cautioned, however, that § 16(b) does not reach every transaction which might involve the possibility of speculative abuse *(Reliance Electric Co. v. Emerson Electric Co.*

(1972) 404 U.S. 418, 422; *Blau v. Lehman* (1962) 368 U.S. 403, 411). The appropriate inquiry is not simply whether a particular "interpretation" might help "curb insider abuses" (see Petition, pp. 10-11) but also whether that interpretation is in accord with the terms of the statute viewed in light of its purpose and history. In its argument that the proviso should be "broadly interpreted" (Petition, pp. 10-11), Foremost assumes the answer to the interpretive inquiry without any examination of these factors.

A. Section 16(b) applies to beneficial owners who enter into short-swing transactions at a time when they are presumed to have access to inside information.

The Ninth Circuit examined the legislative history of § 16(b) in light of its recognized purpose of curbing short-swing speculation by corporate insiders (see Appendix to Petition, pp. 15a-29a). In the case of a beneficial owner, the court concluded that the statute's conclusive presumption of intention to speculate applied to a purchaser who, at the time he made the decision to purchase, was within the class of persons who could reasonably be expected to have access to inside information by reason of their relationship to the corporation (Appendix to Petition, p. 27a). Application of the conclusive presumption to a purchaser who had no such relationship would, as the court noted, "impose an arbitrary hardship on a good faith investor" (Appendix to Petition, p. 27a). These conclusions are in accord with the legislative history which demonstrates that § 16(b) was intended to apply to beneficial owners who enter into short-swing transactions at a time when they may be presumed to have access to inside information.

Under the initial draft presented to Congress, it was clear that insider status must precede the questioned purchase. That draft provided:

> "(b) *It shall be unlawful for any* director, officer, or *owner of securities, owning* as of record and/or beneficially *more than 5 percent of any class of stock* of any issuer, any security of which is registered on a national securities exchange—
>
> "(1) *To purchase* any such registered security with the intention or expectation of selling the same security within 6 months; and any profit made by such person on any transaction in such a registered security extending over a period of less than 6 months shall inure to and be recoverable by the issuer, irrespective of any intention or expectation on his part in entering into such transaction of holding the security purchased for a period exceeding 6 months" (Hearings on S.Res. 84, S.Res. 56 and S.Res. 97, Senate Comm. on Banking and Currency, 73 Cong. (1934) (hereinafter "Senate Hearings"), p. 6430; Hearings on H.R. 7852 and H.R. 8720, House Comm. on Interstate and Foreign Commerce, 73 Cong. (1934) (hereinafter "House Hearings"), p. 9; (emphasis added)).

As Thomas Corcoran, one of the chief draftsmen of the statute explained, this section was intended to prevent

> "• • • any short-term speculations in the stock. He [an insider] cannot, *with his inside information get in and out* of stock within six months" (House Hearings, p. 133; emphasis added).

Thus, the draft affected those who were *already* insiders and might have utilized inside information gained from that relationship in entering into the short-swing transaction.

When the draft was discussed in hearings before Senate and House Committees, there was no suggestion that it should be altered to place more stringent limitations on beneficial owners. To the contrary, there was concern whether beneficial owners should be included at all and, if so, whether the five per cent figure should be raised (see Senate Hearings, pp. 6556, 7741-7743; and see discussion in Appendix to Petition, pp. 20a-23a). There was agreement that directors and officers should be covered by the statute (see Senate Hearings, pp. 6556, 7742-7743). There was also agreement that the statute should cover a sale and repurchase of securities as well as a purchase and sale (see Senate Hearings, pp. 6557-6558; and see discussion in Appendix to Petition, pp. 17a-18a).

The draft was thereafter amended to include a sale and repurchase and also to raise from 5 to 10 per cent the amount of beneficial ownership necessary to bring the statute into play. In the course of amendment, the introductory clause was altered. A declaration of purpose and the proviso here in question were added. Congress declared that § 16(b) was directed against "unfair use of information which may have been obtained by [an insider] by reason of his relationship to the issuer." Congress also specified that, in the case of a beneficial owner, the relationship must exist "both at the time of the purchase and sale." Plainly, there can be no abuse of inside information "at the time of the purchase" if no relationship then exists.

Because Congress' concern was that the draft provision relating to beneficial owners might be too stringent, there is no basis for concluding that the proviso was

intended to change the requirement that beneficial owner status must precede a questioned purchase. To the contrary, the addition of both the proviso and the declaration of purpose makes it clear that Congress intended that such requirement apply to beneficial owners. As this Court has noted, the proviso excludes transactions which "could not have been based on inside information obtained from substantial stockholdings that did not yet exist" (*Kern County Land Co. v. Occidental Corp.* (1973) 411 U.S. 582, 597).

Therefore, as the Ninth Circuit concluded, "at the time of the purchase" means "before giving effect to," rather than "as a result of," the contract of purchase. This reading results in a consistent interpretation of "at the time of" in applying it to a purchase of securities followed by a sale of the same securities. The words "at the time of" modify both "the purchase and sale * * * of the security involved." In all cases of a sale, "at the time of" necessarily means "before giving effect to" the contract of sale. If interpreted to mean "as a result of" the contract of sale, then a single sale of all stock would not be covered by the statute.

As the Ninth Circuit noted (Appendix to Petition, p. 27a) and Foremost stresses (Petition, pp. 8, 15), this interpretation may involve an "inconsistency" in application of § 16(b) to a sale which is followed by a repurchase. If a shareholder sells to below 10% and then repurchases, both the sale and repurchase may well have resulted from inside information gained from stockholdings. In order to bring that transaction within the statute, it is necessary to read "at the time of" as "as a result of" the contract of

repurchase. Such "inconsistency" is, as the Ninth Circuit pointed out (Appendix to Petition, p. 27a), consistent with the statutory purpose. It also involves much less "inconsistency" than reading "at the time of" differently in the case of a purchase and sale of the same securities.

B. There is no merit to Foremost's other arguments.

Certainly, one may speculate about various possibilities of speculative abuse in different factual contexts. However, Congress provided different remedies for different situations and § 16(b) is only one of those remedies. Foremost's complaint that § 10(b) of the Securities Exchange Act (15 U.S.C. § 78j(b), 48 Stat. 891) is not self-operative (see Petition, p. 15) is beside the point. As the Ninth Circuit noted (Appendix to Petition, pp. 28a-29a), § 10(b) was enacted at the same time as § 16(b) to provide a remedy against "manipulative or deceptive" practices (15 U.S.C. § 78j(b), 48 Stat. 891). It is a matter of common knowledge that § 10(b), and Rule 10b-5 (17 C.F.R. § 240.10b-5) formulated under it, have been used with increasing effectiveness (see, generally, Loss, Securities Regulation (Supp. 2d Ed. 1969) Vol. 6, p. 3559; Note, 1974 Duke L. Jour. 610).

Contrary to Foremost's assertion (Petition, p. 16), no anomaly arises from the fact that there were separate "deliveries" of debentures. All "deliveries" were pursuant to the same contract, and hence were part of the same "purchase." And, it is the statute itself which requires that some purchases by beneficial owners be excluded. For reasons already discussed, the Ninth Circuit decided that the statute excluded purchases by investors who could not

be presumed to have access to inside information at the time of their purchase.

Lastly, there is no merit to Foremost's attempt (see Petition, pp. 16-17) to find comfort in certain passages from this Court's opinion in *Kern County Land Co. v. Occidental Corp.* (1973) 411 U.S. 582. There, the Court commented upon the obvious fact that one *becomes* a statutory insider as a result of acquisition of more than 10% of a corporation's outstanding stock (411 U.S. 584, 595, 598). This does not mean that one *is* a statutory insider "at the time of" entry into the contract by which the more than 10% was acquired.[7] Of more significance is this Court's observation in *Kern* that there could be no access to inside information, and thus no liability, arising "from substantial stockholdings that did not yet exist" (411 U.S. 597).

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[7]For example, the opinion notes that "By May 10, 1967, Occidental had acquired more than 10% of the outstanding shares of Old Kern" (411 U.S. 598). It does not conclude that Occidental was an insider at the time it purchased those shares. Rather,

> "It [Occidental] was thus a statutory insider *when, on May 11,* it extended its tender offer • • •" (411 U.S. 598; emphasis added).

CONCLUSION

For the foregoing reasons, we respectfully submit that the petition for a writ of certiorari should be denied.

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[redacted]

Appendix

FEDERAL STATUTES

Securities Exchange Act of 1934, §§ 3(a)(13), 3(a)(14) (15 U.S.C. § 78c(a)(13), (14); 48 Stat. 882, 884):

"(a) When used this chapter, unless the context otherwise requires—

• • • • •

(13) The terms 'buy' and 'purchase' each include any contract to buy, purchase, or otherwise acquire.

(14) The terms 'sale' and 'sell' each include any contract to sell or otherwise dispose of."

Securities Exchange Act of 1934, § 10(b) (15 U.S.C. § 78j(b); 48 Stat. 891):

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

• • • • •

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Securities Exchange Act of 1934, §§ 16(a), 16(b) (15 U.S.C. § 78p(a), (b); 48 Stat. 896):

"(a) Every person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to sec-

tion 78*l* of this title, or who is a director or an officer of the issuer of such security, shall file, at the time of the registration of such security on a national securities exchange or by the effective date of a registration statement filed pursuant to section 78*l*(g) of this title, or within ten days, after he becomes such beneficial owner, director, or officer, a statement with the Commission (and, if such security is registered on a national securities exchange, also with the exchange) of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter if there has been a change in such ownership during such month, shall file with the Commission (and if such security is registered on a national securities exchange, shall also file with the exchange), a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month.

"(b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any

court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

FEDERAL REGULATIONS

Securities and Exchange Commission Rule 10b-5 (17 C.F.R. § 240.10b-5):

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security."